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Senate Passes Trade Bill

On July 21 the Senate passed S 1420, the omnibus trade bill, by a resounding 71-27 vote. Supporters of the legislation pointed enthusiastically to the fact that more than two-thirds of the Senate voted for the bill. (In order to override a presidential veto, 67 "yes" votes are required.) Nonetheless, it would be premature to conclude that some version of the bill will definitely be enacted into law. Several legislators who voted for S 1420 indicated that they will not support the final bill unless objectionable provisions are deleted by the conference committee.

The principal points of the Senate bill are summarized below:

- The bill renews the president's authority to submit trade agreements for fast-track approval. However, congressional participation would be

On the other hand, there is some anger at the president's last-minute appeal to GOP senators to vote against S 1420 on the grounds that this jeopardized the bipartisan spirit that had been present during the crafting of the legislation. The president's resort to partisan appeals and consistent veto threats may prompt intransigence rather than cooperation among the conferees.

Reaction from Japan has been vocal. After the vote several Japanese officials expressed dismay at the legislation, charging that it was blatantly protectionist and contained provisions contrary to the General Agreement on Tariffs and Trade. Of the "super 301" provision, an official Japanese statement read that "this section not only runs counter to the spirit of due process by making absolutely one-sided prejudgments about Japan, but also makes a mockery of the Japanese achievement over the years in dramatically enhancing market access, heightening the emotional reaction in Japan and seriously frustrating the will on the part of Japan to continue its pursuit of further market opening and macroeconomic/structural policies."

Eileen Marie Doherty

Japan's Soaring Capital Outflow To United States

The net flow of long-term capital from Japan to the United States nearly doubled to $65.7 billion in 1986, reflecting this country's continued reliance on foreign capital to fund its large government budget deficit and private business investment. Securities, principally bonds, remained the primary form of investment, accounting for 85 percent of the total (see Table 1). There was also a significant jump in direct foreign investment from $2 billion in 1985 to $7.8 billion last year.

The net long-term capital flow exceeded Japan's current account surplus with this country, which rose to $53.8 billion last year. The merchandise trade balance, the major item in the current account, climbed to $54.9 billion in Japan's favor as a result of a 22.5 percent jump in exports. On the services account, though, Japan continued to run a deficit with the United States, as its surplus in investment income and transportation failed to balance deficits in travel, patent royalties and management fees. But the rise in net investment income to $3.2 billion did push the services account toward balance.

Foreign direct Japanese investment has been encouraged by the strong yen, which has made overseas investments less expensive, as well as by the need to cut costs to remain competitive and the threat of protectionism. With the exponential growth in overseas investment, the Economic Planning Agency predicts that the proportion of manufacturing carried out abroad by Japanese firms will rise from 4.3 percent in 1984 to 8.2 percent in 1993, although it will still be less than half of the 18 percent to 20 percent shares held by the West German and U.S manufacturing industries. The United States remains a prime location for Japanese investment, accounting for over half of the worldwide total in 1986 (see Table 2). And this trend is likely to continue: in an EPA survey of firms that expect to invest abroad during the next three years, 66.6 percent view North America as a probable site, followed by 55.3 percent for the newly industrialized countries of Asia.

Table 1: Japan's Balance of Payments with the United States, 1982-86

(in millions of dollars, IMF value basis)

	1982	1983	1984	1985	1986
Merchandise Trade Balance	$15,131	$21,211	$36,704	$42,988	$54,919
Exports	36,477	43,057	60,479	65,617	80,385
Imports	21,346	21,846	23,775	22,629	25,466
Services Balance	-677	-1,884	-1,495	-1,012	-585
Transportation	-733	-573	-37	110	243
Travel	-1,274	-1,319	-1,369	-1,329	-2,012
Investment Income	2,140	1,280	1,379	2,268	3,231
Other	-810	-1,272	-1,468	-2,061	-2,047
Official	1,148	1,314	1,397	1,495	1,931
Private*	-1,958	-2,586	-2,865	-3,556	-3,978
Unilateral Transfers Balance	-120	-176	-191	-249	-552
Official	-11	-18	-44	-27	-92
Private	-109	-158	-147	-222	-460
Current Account Balance	14,334	19,151	35,018	41,727	53,782
Long-Term Capital (net)	-1,700	-5,541	-14,814	-33,163	-65,650
Direct Investments (net)	-1,423	-1,041	-3,180	-2,043	-7,774
Trade Credits (net)	-788	-190	-195	-587	-334
Loans (net)	-243	-329	-477	-716	-690
Securities (net)	1,248	-3,943	-10,591	-29,874	-55,944
Other (net)	-494	-38	-371	57	-908
Basic Balance	12,634	13,610	20,204	8,564	-11,868

*Includes such items as management fees, patent royalties and nonmerchandise insurance.

Note: For long-term capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Bank of Japan

According to Bank of Japan data, U.S. securities accounted for about half of the $102 billion worth of Japanese purchases of foreign securities in 1986. Given the 42.4 percent drop in the dollar since February 1985, investors have been hurt by this emphasis on U.S. financial instruments. The Japanese life insurance industry, for example, which holds an estimated Y8 trillion ($53.3 billion at Y150=$1.00) in foreign bonds, suffered exchange losses of Y2.2 trillion ($14.7 billion) in FY 1986 on top of Y944 billion ($6.3 billion) the preceding year. These large losses have reportedly encouraged some diversification into securities denominated in European currencies. Sumitomo Mutual Life Insurance Co., Ltd., for instance, has cut the proportion of dollar assets in its total foreign currency-denominated investments from 80 percent last year to 50 percent.

Table 2: Japan's Regional Balance of Payments, 1986

(in millions of dollars, IMF value basis)

A. Services

	United States		European Community		Other Countries		Other*		World	
	Credits	Debits	Credits	Debits	Credits	Debits	Credits	Debits	Credits	Debits
Transportation	$3,778	$3,535	$2,056	$1,840	$5,482	$8,478	$0	$0	$11,316	$13,853
Travel	641	2,653	150	1,333	671	3,243	1	0	1,463	7,229
Investment Income	8,520	5,289	7,446	7,069	11,390	7,164	1,730	91	29,086	19,613
Other	5,669	7,716	1,451	4,029	4,629	6,163	86	29	11,835	17,937
Total	18,608	19,193	11,103	14,271	22,172	25,048	1,816	120	53,700	58,632

B. Long-Term Capital

	United States		European Community		Other Countries		Other*		World	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Direct Investments	$-7,973	$199	$-2,748	$54	$-3,759	$-27	$0	$0	$-14,480	$226
Trade Credits	-342	8	-1,088	1	-406	-49	0	0	-1,836	-40
Loans	-612	-78	-1,102	64	-8,217	2	650	-22	-9,281	-34
Securities	-49,395	-6,549	-40,624	11,611	-7,286	-5,381	-4,672	864	-101,977	545
Other	-864	-44	-555	1	-612	-30	-2,490	10	-4,521	-63
Total	-59,186	-6,464	-46,117	11,731	-20,280	-5,485	-6,512	852	-132,095	634

*Includes international institutions and unallocated flows.

Note: For long-term capital transactions credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Bank of Japan

According to many analysts, Japanese investors' ability to diversify away from dollar-denominated securities is limited by the large size of their portfolios. At the same time, the rise in U.S. interest rates and the recent stability of the dollar has renewed interest in U.S. securities, contributing to a record $14.1 billion in net purchases of foreign bonds in June. At present, a 10-year U.S. bond yields about 5 percentage points more than an equivalent Japanese security. Robert Brusca of Nikko Securities Co. International Inc. in New York calculates that the yen would have to appreciate by an additional 60 percent over the next decade in order for Japanese investors to make less than they would have if they had held yen bonds over the same period.

Randall S. Jones

Tokyo Debates Toshiba Machine Sales

Although Prime Minister Yasuhiro Nakasone has condemned the sale of sophisticated milling machines by Toshiba Machine Co., Ltd. to the Soviet Union as betraying the Japanese people, opinion is still divided on the damage incurred by the incident and the appropriate response by the government. While most observers agree that the sale was one of several elements that enabled the Soviets to manufacture significantly quieter submarines, many insist that other aspects of the program -- including propeller designs, internal drives and more efficient hull configurations -- were at least equally responsible for the improvements, none of which involved the Japanese company.

The disagreement over the actual extent of the damage done by Toshiba Machine is not simply an exercise in avoiding responsibility. The diversity of views being expressed represents profound differences in Japanese and American perceptions of strategic threats. Furthermore, the discussions serve as the political basis that will help form the response by the cabinet to preventing future leaks of advanced technology to potentially hostile powers.

The first issue at hand is the nature of the threat facing Japan. One of the most perplexing -- and troubling -- aspects of the Toshiba Machine incident is the failure on the part of the Japanese public to realize that the improved capabilities of Soviet submarines constitute a threat not only to the United States but also to Japan and the Western alliance. There has been a notable absence in this debate of the link between the technology involved and Japan's security. Rather, there is a perception that the United States is irritated by the company's actions because they threaten U.S. security.

This reflects the postwar Japanese ambivalence toward the Soviet Union and the more recent conflict between identifying the country as an overt threat to the nation's security and a potential market for Japanese products. Despite the growing readiness in Japan to name the U.S.S.R. as the primary threat to the country's security, there never has been unanimous agreement about the nature, extent or appropriate response toward that threat. Furthermore, the reaction of those skeptical of the seriousness of the Soviet threat reflects either a lack of appreciation or a basic disregard for the fundamental assumptions underlying the nature of the U.S. security guarantee to Japan -- namely, that Japan's self-defense rests heavily on the United States' ability to extend a credible deterrent threat. That this credibility is undercut by such advances as improved Soviet submarines, particularly in terms of the U.S. extension of a "nuclear umbrella" over Japan, appears largely absent from the general public's perception.